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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, DC 20554**

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| **In the Matter of** | ) | |
| **Verizon Telephone Companies** | ) | **WC Docket No. 02-317** |
| **Tariff FCC Nos. 1 & 11** | ) | |
| **Transmittal No. 226** | ) | |
| | ) | |

# WORLDCOM OPPOSITION

WorldCom, Inc. (WorldCom) hereby submits its opposition to the Direct Case filed in the above-captioned proceeding on October 29,2002 by the Verizon Telephone Companies (Verizon).

## I. The Proposed Tariff Language Violates Sections 201 and 202 of the Act

**All** suppliers of telecommunications services seek to reduce credit risk to the greatest extent possible. However, the degree to which a competitive carrier can reduce its credit risk is limited by market forces. As the carrier takes increasingly stricter measures to control its risk of nonpayment, by demanding larger security deposits or demanding such deposits from a larger population of customers, at some point the carrier's customers respond to those growing burdens by switching to competing carriers that are willing to accept higher levels of risk in order to win business. In that manner, the market balances competitive carriers' credit risk against the burdens placed on customers.

By definition, however, market forces cannot constrain the ability of a dominant carrier such as Verizon to impose excessive burdens on customers as it **seeks** to reduce its

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credit risk. Because dominant carriers have no concerns that an overly stringent security deposit policy could drive away customers, a dominant carrier is unlikely, in the absence of regulatory constraints, to balance the carrier's interest in reducing credit risk against the burdens placed on the carrier's customers.

On numerous occasions, the Commission has found that dominant LEC tariff terms and conditions are just and reasonable only if they reflect a similar balancing of carrier and customer interests to that found in a competitive market. For example, in considering security deposit provisions, the Commission has "recogniz[ed] that it is prudent for the telephone company to seek to avoid non-recoverable costs imposed by bad credit risks."[1] At the same time, however, the Commission has rejected "vague charges [that] could become unreasonably burdensome," provisions that "allow[ed] the telco unnecessarily broad discretion" and provisions that had "potential anticompetitive effects."[2]

Similarly, when considering 1987 BellSouth tariff revisions that were intended to mitigate the impact of potential customer bankruptcy, the Commission "recognize[d] that the proposed tariff revisions could reduce BellSouth's liability under the circumstances that it has described."[3] At the same time, however, the Commission "believe[d] . . . that the revisions may place undue burdens on customers . . . . Provisions that more directly applied only to those customers that might default and that are supported with adequate documentation would be more reasonable."[4]

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[1] Investigation of Access and Divestiture-Related Tariffs, <u>Memorandum Opinion and Order</u>, CC Docket No. 83-1145 Phase I, 97 FCC 2d 1082 (1984) (<u>Phase I Order</u>), Appendix D, discussion of Section 2.4.1(A).
[2] <u>Id</u>.
[3] Annual 1987 Access Tariff Filings, <u>Memorandum Opinion and Order</u>, 2 FCC Rcd 280, 304-305 (1986).
[4] <u>Id</u>.

**As** the Commission recognizes in the Designation Order, the tariff revisions proposed in Verizon Transmittal No. 226 "significantly alter the balance between Verizon and its interstate access customers with respect to the risks of nonpayment of interstate access bills that was struck in the early 1980s when access charges were instituted."' The Commission should reject Verizon Transmittal No. 226 because the tariff language proposed by Verizon does not balance Verizon's interests against those of its customers. The proposed tariff would provide Verizon with a far better level of protection against bad debt than could be obtained in a competitive market and would impose excessive burdens on Verizon's customers.

## A. Verizon Has Failed to Provide Information Required by the Designation Order

**As** an initial matter, Verizon's Direct Case fails to meet its burden of proof under section 204 because it does not comply with the Designation Order's requirement that Verizon demonstrate how each of the factors listed in the proposed tariff language "is a valid predictor of whether the carrier will pay its interstate access bill."[6]

In its Direct Case, Verizon responds to the Designation Order's question about he predictive power of its proposed tariff by asserting that bond ratings and payment history are correlated with risk.' Verizon fails to recognize, however, that it is not enough to show that bond ratings and payment history are correlated with risk. Even assuming arguendo that bond ratings and payment history are reasonable factors to examine, the impact of Verizon's

[5] Designation Order at ¶ 11.
'Designation Order at ¶ 21.
[7] Direct Case at **A-3** ("... it is well established that '[c]redit ratings provide objective, consistent and simple measures of creditworthiness' and are regarded as 'a key measure of a company's financial health"')

scheme would be determined in large part by the particular "triggers" specified in Transmittal No. 226, i.e., the "investment grade" trigger for the bond rating criterion and the "two months late or $250,000 in arrears" trigger for the late payment criterion. It is those triggers that determine which customers would be targeted for security deposit requests, and thus determine the level of credit risk that Verizon would bear. Consequently, in order to be able to assess the validity of Verizon's scheme, the Commission would have to be able to evaluate the credit risk and customer burdens associated with the particular triggers proposed by Verizon, not merely the general utility of bond ratings or payment history as measures of risk. Verizon has, however, failed to provide the Commission with any information about the credit risk or customer burdens that would result from application of particular triggers proposed in Transmittal No. 226.

Unless Verizon simply picked the triggers out of thin air – which is, of course, entirely possible -- Verizon must have estimated the level of uncollectibles that its proposed scheme would yield and the number of customers that its proposed policy would capture. Because Verizon has failed to provide that information to the Commission in response to the Designation Order's question about the predictive power of its proposed scheme, the Commission must find that Verizon has failed to meet its burden of proof under section 204(a). Without specific information about Verizon's credit risk and the corresponding customer burdens, the Commission cannot readily determine whether Verizon is proposing a balanced approach that targets only those customers that present a significant risk of nonpayment, or is instead proposing an unreasonably stringent approach that targets any customer that presents even the slightest risk of nonpayment.

## B. Verizon Already Enjoys Good Protection Against Credit **Risk**

Verizon contends in its Direct Case that its proposed tariff language is reasonable because Verizon is merely seeking to gain protections similar to those available to other carriers.[8] But, as discussed in more detail below, Verizon's contention that it is disadvantaged by its current tariff language or by its common carrier obligations is without merit. To the contrary, as discussed in more detail below, Verizon actually enjoys a better risk profile than could be obtained by competitive carriers. Consequently, any step to further reduce Verizon's credit risk would not reflect a reasonable balancing of carrier and customer interests, and thus would be unlawful under section 201.

Verizon's Direct Case provides no support for Verizon's assertion that its protection against bad debt is somehow weaker than that of other firms. Indeed, Verizon fails to respond to the Designation Order's request that Verizon provide data concerning the level of uncollectibles in the broader marketplace' – even though, as a participant in the wireless, long distance, and Internet markets, Verizon should at least be able to compare the uncollectibles experienced by its LEC operations with the level of uncollectibles in those other, more competitive, markets.

It is irrelevant that Verizon's uncollectibles may have increased in 2000 and 2001. **As** an initial matter, because uncollectibles always vary with the business cycle, an increase in Verizon's uncollectibles from one year to the next is not necessarily an indicator of a permanent increase in Verizon's level of risk. Most of the factors that Verizon cites as

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[8] Direct Case at 3

driving the increase in uncollectibles are one-time events, linked to the end of the telecommunications investment boom of the late 1990s.

Moreover, even if the increase in Verizon’s uncollectibles reflects a permanent increase in Verizon’s risk, that would still not support Verizon’s claim that it is disadvantaged relative to other carriers. There is, in particular, no evidence that the increase in uncollectibles in 2000 and 2001 is a phenomenon that has uniquely affected Verizon. At the same time that Verizon’s uncollectibles have been increasing, every other firm in the industry has also seen its uncollectibles increase. Time Warner Telecom, for example, recently reported to the SEC that its uncollectibles expense has increased due to customer bankruptcies.” Consequently, the increase in uncollectibles provides no evidence that Verizon’s protection against bad debt is weaker than that of other firms.

Given that there is no evidence that the increase in uncollectibles in recent years has left Verizon facing uniquely high risks, the increase in uncollectibles provides no basis for permitting Verizon additional protections. Verizon’s risk profile of 1984 or 1990 is not the standard by which the reasonableness of Transmittal No. 226 should be judged. If, as Verizon claims, Verizon’s business has become riskier because of “regulatory and political decisions to move to a model that encourages” competition,” then it would be inconsistent with those decisions to restore Verizon’s risk profile to that of a monopoly carrier in the more heavily regulated market of 1984 and 1990. In return for granting the ILECs increasing flexibility to respond to new competition, the Commission has at the same time

[9] Direct Case, Appendix **A-32.**
[10] Time Warner Telecom, SEC Form 10-K, March **28,2002,** at 34
[11] Direct Case at **15.**

taken steps to eliminate regulations that insulate the ILECs from risk.[12] Verizon's effort to restore its uncollectibles percentage to the level it enjoyed in 1984 or 1990 is inconsistent with those steps.

Finally, there is no merit to Verizon's contention that nondominant carriers' tariff language "constitutes strong evidence that the criteria set forth in Verizon's proposed tariffs . . . are market-based and reasonable."[13] The Commission has consistently rejected ILECs' claims that they should be permitted the same tariffing flexibility as nondominant carriers. It is the Commission's longstanding policy that dominant carrier tariff transmittals are subject to a higher level of scrutiny in the tariff review process.[14] That higher level of scrutiny is necessary because dominant carriers continue to possess market power. Nondominant carriers, by contrast, "simply cannot rationally price their services in ways which, or impose terms and conditions which, would contravene Sections 201(b) and 202(a) of the Act."[15] If a nondominant carrier sought to implement a security deposit policy that did not reasonably balance the interests of the carrier with the interests of its customers, that carrier "would lose its market share as its customers sought out competitors whose prices and terms and more reasonable."[16] By contrast, because Verizon remains a dominant carrier, market forces cannot ensure that Verizon's security deposit policy is just and reasonable. Consequently, the Commission must ensure, through the tariff review process, that Verizon's tariff limits

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[12] See, e.g., Access Charge Reform, Fifth Report and Order, CC Docket No. 96-262, released August 27, 1999, at ¶ 164 (eliminating low-end adjustment mechanism).
[13] Direct Case at 6.
[14] See, e.g., Southwestern Bell Telephone Company, Revisions to Tariff FCC No. 73, Transmittal No. 2316, Order, 9 FCC Rcd 1883, 1884 ¶ 8 (1994).
[15] Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorization Therefor, First Report and Order, 86 FCC 2d 1, 31.
[16] Id.

Verizon to a security deposit policy that reasonably balances Verizon's interests with those of its customers.

### C. Verizon's Proposed Criteria for Triggering Security Deposit Requests are Unreasonable

Not only has Verizon failed to demonstrate any basis for a further reduction in its credit risk, hut the particular scheme contained in Transmittal No. 226 is patently unjust and unreasonable. It would provide Verizon with a far better level of protection against bad debt than Verizon could obtain if the access market were competitive.

#### 1. Verizon's "Investment Grade" Trigger Would Not be Commercially Viable in a Competitive Market

WorldCom does not use a bond rating-based test, much less a bond rating-based test with an "investment grade" trigger, in determining whether a customer's financial condition might warrant a request for some type of security. And it is highly unlikely that any competitive carrier employs a policy that either directly or indirectly targets all non-investment grade customers. Although "non-investment grade" customers may be riskier than "investment grade customers," most "non-investment grade" customers still possess sufficient liquidity to continue paying their hills for the foreseeable future. According to Standard & Poor's, for example, a firm with a " B rating "currently has the capacity to meet its financial commitment on the obligation."[17] Similarly, according to Moody's, the default rate for a "B1"-rated issuer is only 3.71 percent" -- and the credit loss rate, which includes

[17] Standard & Poor's Corporate Ratings Criteria at 8 (http://www2.standardandpoors.com/spf/pdf/fixedincome/corpcrit2002.pdf).
[18] Moody's Investors Service, "Default and Recovery Rates of Corporate Bond Issuers," February *2002,* at 14, Exhibit 13. (http://riskcalc.moodysrms.com/us/research/defrate/02defstudy.pdf).

amounts recovered during bankruptcy proceedings, is even lower. If a competitive carrier were to demand security deposits from such customers, it would quickly lose those customers to other carriers willing to absorb such a minimal level of risk without demanding a security deposit.

It should not be surprising that a below-investment grade bond rating is not a commercially viable trigger for security deposit requests. The investment grade rating was not developed to determine the point at which a security deposit would be appropriate in a commercial transaction; rather, the term "investment grade" was originally used by regulatory bodies to connote obligations eligible for investment by institutions such as banks, insurance companies, and savings and loan associations.[19] There is no basis for the Commission to find that risk level of a pension fund or bank, which operates under government regulations designed to ensure stability, is the appropriate benchmark for Verizon's security deposit tariff.

### 2. Verizon's Late Payment Trigger Would Not be Commercially Viable in a Competitive Market

A carrier subject to market forces would not find it to be commercially viable to assess a security deposit on any customer with two late payments in a year or an outstanding balance of $250,000. Indeed, a payment history of two late payments in a year is so common as to be useless as a predictor of risk. Any competitive carrier that sought to impose such a policy would quickly lose its customers to carriers that employed a more targeted approach to controlling their credit risk.

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[19] Standard & Poor's Corporate Ratings Criteria at 9 (http://www2.standardandpoors.com/spf/pdf/fixedincome/corpcrit2002.pdf)

It is disingenuous for Verizon to contend that the "two months late payment or $250,000 in arrears" criterion is "simply a specific iteration of existing tariff provisions which already allow Verizon to require a security deposit from a customer 'which has a proven history of late payments to the Telephone Company.'"[20] To the best of WorldCom's knowledge, neither Verizon nor any other ILEC has in the past interpreted two late payments in a year, no matter how inconsequential, as rising to the level of a "proven history of late payment." Certainly, Verizon has provided no evidence that a pattern of two late payments in a year identifies only those customers that present a substantial risk that they will not pay their bills in the future.

### 3. Verizon's Proposed Policy Would Reduce Its Risk to Zero

Not only are the specific criteria proposed by Verizon far more stringent than any competitive carrier could employ, but those criteria would combine to provide Verizon with a level of credit risk that would be far lower than any competitive carrier could obtain. In fact, Verizon's uncollectibles under its proposed policy would probably be lower than Verizon experienced even in the "best" years in the past.

Although the lack of data in Verizon's Direct Case makes it difficult to estimate Verizon's uncollectibles rate under the scheme proposed in Transmittal No. 226, the available evidence indicates that Verizon's uncollectibles percentage would approach zero. Under Verizon's scheme, the only large customers that would not be required to pay a security deposit would be investment grade firms that have not been placed on review for a potential downgrade. According to Moody's, the default rate for such firms is only slightly

[20] **Direct Case** at **A-2.**

greater than zero – *less **than** 0.06 percent*.[21] Verizon's proposed scheme reduces that miniscule risk still further through application of the late payment criterion, which would likely capture many investment grade firms that managed to escape the bond rating-based criterion and many customers too small to have rated debt.

While it is understandable that Verizon would want to reduce its credit risk as close to zero as possible, such a policy is not just and reasonable. In order to achieve such a low level of risk, the tariff language proposed in Transmittal No. 226 would demand security deposits fiom any customer that presents even the slightest risk of nonpayment. No firm operating in a competitive market could ever hope to implement such a broad-based security deposit policy; market forces prevent competitive firms from demanding security deposits from customers other than the very limited number that present a substantial credit risk.

**D. Transmittal No. 226 Conflicts with the Bankruptcy Code**

In Transmittal No. 226, Verizon proposes to amend its tariff to allow Verizon to demand a security deposit or advance payment fiom any customer that has "commenced a voluntary receivership or bankruptcy proceeding (or had a receivership or bankruptcy proceeding initiated against it)."[22] That provision is unlawful because it conflicts with the U.S. Bankruptcy Code.

Under Section ***366*** of the Bankruptcy Code, utilities such as Verizon may not discontinue service unless the debtor fails to furnish "adequate assurance" of payment in the

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[21] Moody's Investors Service, "Default and Recovery Rates of Corporate Bond Issuers," February 2002, at **9.** (http://riskcalc.moodysrms.com/us/research/defrate/02defstudy.pdf).

[22] Transmittal No. 226, Tariff FCC No. 1, 1st Revised Page 2-26.

form of a "deposit or other security." Verizon contends that its proposed tariff language is consistent with the Bankruptcy Code because, it claims, the amount constituting adequate assurance may be initially set by the utility.[23] However, as even the cases cited by Verizon make clear, "[t]he bankruptcy courts are in agreement that section 366(b) vests in the bankruptcy court the exclusive responsibility for determining the appropriate security which a debtor must provide to its utilities to preclude termination of service for non-payment of pre-petition utility bills. . . ."[24] Given that the bankruptcy court has "exclusive responsibility" to determine "the appropriate security," Verizon's proposal to fix that security by tariff plainly creates a conflict with the Bankruptcy Code.

## 11. The Proposed 7- and 10-day Notice Periods are Unreasonable

**As** the Commission has explained, the 30-day notice period in Verizon's current tariff is essential because it allows sufficient time for the LEC and customer to investigate or cure alleged tariff violations before the LEC takes the drastic step of refusing or discontinuing service. In the Phase I Order, for example, the Commission noted with approval commenters' statements that the 30-day notice period "provides reasonable time for [customers] to convey their concerns to the telco."[25] And, in reviewing BellSouth's 1987 proposal for a 15-day notice period, the Commission expressed concern that the BellSouth proposal "may impair the cooperative spirit we have attempted to promote between carriers

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[23] Direct Case at A-24.
[24] See, e.g., Adelphia Business Solutions et al., 2002 Bankr. LEXIS 705, *48 (citing Begley **v.** Philadelphia Elec. Co., 41 B.R. 402 (E.D. Pa. 1984), aff'd 760 F.2d 46 (3rd Cir. 1985)) (emphasis added).
[25] Phase I Order, Appendix D, discussion **of** section 2.1.8.

and customers."[26]

Reducing the notice period from **30** days to 7 days would drastically alter the balance of power in any dispute between Verizon and its customers. The threat of imminent refusal or discontinuance of service would give Verizon an unreasonable degree of leverage in any negotiations between Verizon and the customer concerning the alleged tariff violations. Given that there are in many instances no alternatives to Verizon's interstate access services, and that customers would be unable to switch in time even if alternate facilities were available, customers receiving a 7-day notice simply could not afford to risk the possibility that Verizon would stop processing orders or terminate service altogether.

Verizon contends in its Direct Case that the 7-day notice period is reasonable because "Verizon generally will embargo services only after it and the customer have been involved in negotiations, and after an outstanding balance is ninety days or more past due."" But there is nothing in Verizon's tariff that guarantees customers such a negotiation period. Verizon would be able to issue the 7-day refusal or discontinuance notice **as** soon as it believed that a tariff violation had occurred, without any preliminary negotiations.

Furthermore, there is no merit to Verizon's suggestion that the shorter 7-day notice period would "encourage Verizon to continue to negotiate with the carrier to reach a solution short of sending a termination or embargo notice."" To the contrary, Verizon's statements in the Direct Case that it customarily engages in lengthy negotiations shows that it is the 30-day notice period that encourages fruitful negotiations – exactly as the

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[26] 1987 Access Tariff Order, *2* FCC Rcd at **304**
[27] Direct Case at B-2.
[28] Direct Case at *B-3*.

Commission intended.

In any event, Verizon's proposal to reduce the notice period to 7 days is an excessively broad response to a limited problem. While Verizon presents the shorter notice period as a tool for limiting exposure to financially-troubled customers,[29] the shorter notice period's application is not limited to only those customers where there is a high risk of nonpayment. Rather, Verizon could invoke the 7-day notice period with respect to any dispute, with any customer, where Verizon could allege a tariff violation, regardless of the customer's financial condition.

## 111. The Refund Provisions are Not Just and Reasonable

Under the tariff language proposed in Transmittal No. 226, Verizon will return a security deposit at the customer's written request only if the customer's account balance has been paid in full, the customer no longer satisfies any of the six criteria for requiring a security deposit, and the customer has not met the six criteria for at least one year.

Even assuming arguendo that the six criteria specified in Transmittal No. 226 are reasonable – which they are not, for the reasons discussed above – it is, at a minimum, unreasonable for Verizon to retain a security deposit for a year or more after the customer no longer meets any of the six criteria. Any customer that does not meet any of the six criteria must already represents a sufficiently low risk of nonpayment that the additional one-year waiting period is not required to safeguard Verizon's interests.

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[29] Direct Case at B-2

## IV. Verizon Has Failed to Satisfy the Substantial Cause Test

### A. Transmittal No. 226 is Subject to the Substantial Cause Test

Verizon cannot escape the requirements of the substantial cause test by unilaterally declaring that the security deposit provisions are not “operative conditions” of its term plans.” **As** Verizon admits;’ term plan customers are automatically subject to the security deposit provisions of Verizon’s tariff, and would become subject to the new tariff language if Transmittal No. 226 were to take effect. It is irrelevant that the security deposit language is incorporated into the term plans by reference, rather than being repeated in each of the term plan sections of Verizon’s tariff.

Permitting Verizon to make changes to the security deposit provisions applicable to term plans would be at odds with the policy basis for the substantial cause test. In the <u>RCA Americom Decisions</u>, the Commission stated that it “strikes us **as** anomalous that a carrier could use the tariff filing process to prevent any of its service terms from being enforced against it by customers, while at the same time bind customers to all the tariff provisions for as long as the carrier wishes . . . .”[32] Given that existing term plan customers are subject to substantial termination liabilities if they elect to leave Verizon, it would be “anomalous” if those customers could suddenly be subjected to more onerous security deposit demands. Those customers made multi-year commitments to Verizon with the expectation that they would have to pay security deposits only if they had a “proven history of late payment.”

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”Appendix D-2.

[31] <u>Id</u>.

[32] RCA American Communications, Inc., <u>Memorandum Opinion and Order</u>, **84** FCC 2d **353,358-359 ¶** 17.

## B. Verizon Has Not Met the Requirements of the Substantial Cause Test

Verizon contends that it meets the substantial cause test because, it asserts, “the current economic climate – which has shown an explosive growth in carrier uncollectibles – makes those changes absolutely essential.”” But such generalized assertions of potential harm do not provide the requisite showing.[34] It is well established that mere reductions from anticipated revenues do not constitute substantial cause.[35] Rather, the carrier must demonstrate unanticipated changes in business circumstances of such degree that they would “constitute an injury to [the carrier] that outweigh[s] the existing customers’ legitimate expectation of stability.”[36] The Commission has, for example, suspended tariffs when the customer failed to demonstrate that “its projected losses [were] sufficiently large or certain to demonstrate ‘substantial cause.’”[37]

Verizon cannot demonstrate injury sufficient to outweigh existing customers’ legitimate expectation of stability. ARMIS data show that Verizon’s uncollectibles rate for special access, which is a good proxy for Verizon’s term plan uncollectibles,” was extremely low in 2001 – about **1.2** percent (**$58** million of Verizon’s $4.7 billion in special access revenues).”

[33] Direct Case at 27-28.
[34] AT&T Communications Contract Tariff No. 360, Order, 11 FCC Rcd 3194, ¶ 21 (1995) (AT&T Contract No. 360 Order).
[35] AT&T Communications Revisions to Tariff FCC No. *2*, Order, *5* FCC Rcd 6777,6779 ¶ 21 (1990) (AT&T Tariff No. *2* Order).
[36] Id.
[37] AT&T Contract No. 360 Order at ¶ 20.
[38] Special access services account for the vast majority of Verizon’s term plan revenues.
[39] Verizon ARMIS 43-01, col.s, lines 1060, 1090.

Moreover, Verizon is unable to show that "it will fail to recover its costs or that net revenues [from term plan services] will become negative."[40] Indeed, rate of return data show that the modest rate of uncollectibles on term plan services has caused Verizon no injury at all. Verizon earned over 21 percent on special access services in 2001,[41] far above Verizon's cost of capital and the Commission's most recently-prescribed rate of return of 11.25 percent.

[40] AT&T Tariff No. 2 Order, 5 FCC Rcd at **6779, ¶** 21.
[41] Verizon **ARMIS** 43-01, col.s, lines **1910** (total Verizon special access average net investment of $5.8 billion), **1915** (total Verizon special access return of $1.2 billion).

## V. Conclusion

For the reasons stated herein, the Commission should reject Verizon Transmittal No. 226.

Respectfully submitted,
WORLDCOM, INC.

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